

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Alarcon Analyst: Roger Lackey Bill Number: SB 1568

Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: April 6, 2000

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Enterprise Zone Designation Limits/Authorizes An Additional 11 Zones/Enterprise Hiring Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 18, 2000, STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

Under the Government Code, this bill would increase the number of enterprise zones that may be designated from 39 to 50 over a 4-year period starting in 2001. Also, the bill would provide the Trade and Commerce Agency (TCA) the authority to approve an application for the reconfiguration of the geographic boundaries of an existing enterprise zone with certain guidelines.

Under the Personal Income Tax Law (PITL) and Bank and Corporation Tax Law (BCTL), this bill would allow a taxpayer in an enterprise zone to claim a credit equal to 10% of the portion of wages paid to a "qualified employee" that is between 150% and 200% of the minimum wage for each of the first six years of employment.

Also, under the PITL and BCTL, this bill would provide an additional credit equal to 10% of the qualified wages for each of the first seven years of employment in which the employer provided fully paid health benefits to the employee. For purposes of this credit, qualified wages are defined as the portion of wages that does not exceed 150% of the minimum wage.

This analysis will address the bill's changes to the Government Code only as they impact the department or state income tax revenue.

SUMMARY OF AMENDMENT

The April 6, 2000, amendment added language that would provide that the report required to be submitted by the TCA to the Legislature would include an analysis of the extent to which new jobs or new business activity in enterprise zones are the result of relocations from out-of-state or from other California locations. This amendment would not impact the department.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> X PENDING

Legislative Director

Date

Johnnie Lou Rosas

4/12/00

The March 27, 2000, amendment added language that would increase the number of enterprise zones that can be designated by the TCA from 39 to 50 over a four-year period.

This March 27th amendment also added the credits discussed above. As a result of the March 27, 2000, amendment, a new Effective Date, Specific Findings, Policy Considerations, Implementation Considerations, and Departmental Costs have been included below.

EFFECTIVE DATE

This bill would be effective January 1, 2001; however, the credits created by this bill would be specifically operative for taxable or income years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within an enterprise zone. These incentives include a sales or use tax credit, hiring credit, business expense deduction, special net operating loss treatment, and net interest deduction. In addition, a wage credit may be claimed by specified employees of businesses operating within an enterprise zone.

For purposes of the hiring credit, a business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (under special circumstances for the Long Beach enterprise zone, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

This bill would increase the number of enterprise zones that may be designated at one time from 39 to 50 over a four-year period starting in 2001 as follows:

- ⌚ From January 1, 2001, to December 31, 2001, no more than 44 enterprise zones shall have been designated.
- ⌚ From January 1, 2002, to December 31, 2002, no more than 46 enterprise zones shall have been designated.
- ⌚ From January 1, 2003, to December 31, 2003, no more than 48 enterprise zones shall have been designated.
- ⌚ On and after January 1, 2004, no more than 50 enterprise zones shall have been designated.

In addition to the existing enterprise zone hiring credit, under the PITL and BCTL, **this bill** would allow a taxpayer in an enterprise zone to claim a credit equal to 10% of the portion of wages paid to a "qualified employee" that is between 150 and 200% of the minimum wage for each of the first six years of employment.

Also, under the PITL and BCTL, **this bill** would provide an additional credit equal to 10% of the qualified wages for each of the first seven years of employment in which the employer provided fully paid health benefits that included full dependent coverage and which the employer pays 100% of the premium, excluding minimal co-payments.

This bill would define "qualified employee" to be an employee as defined in Sections 17053.74 and 23622.7 of the Revenue and Taxation Code, which are the current enterprise zone hiring credit sections. The same sections are used to define "qualified wages" for the second credit.

Policy Considerations

Current incentives available in enterprise zones are restricted in their utilization to the income and tax generated within the enterprise zone. This bill would not limit the credits claimed to the income and tax generated within the enterprise zone.

This bill does not require the wage deduction to be reduced by the amount of the credit; therefore, the taxpayer would receive a double benefit.

The credits created by this bill are allowed on the same expenditures as the existing credits. For example, the existing hiring credit is for a variable percentage of wages up to 150% of the minimum wage, while the credit for the employer who pays the employee's health benefits is for 10% of wages up to 150% of the minimum wage. Therefore, the taxpayer would receive additive credits - one credit under the existing hiring credit and another under the health benefits credit as a result of paying employee's health benefits, both for wage expenses up to 150% of the minimum wage. The same employees could also qualify the taxpayer for the new 10% credit for wages between 150% and 200% of minimum wage.

The credits enacted by this bill would be allowed indefinitely. Credits are typically enacted with a sunset date of four or five years, to ensure that the Legislature has an opportunity to periodically review their effectiveness

The bill does not contain any language allowing these credits to be carried over to future years in the event a taxpayer is unable to fully utilize the credit in the year in which the expenditure is paid or incurred. Thus, any credit which cannot be used against the taxpayer's tax liability for the year would be lost. Credits are typically enacted with a carryover period limit of eight years, to allow the taxpayer sufficient time to use the full credit.

Implementation Considerations

The term "minimum wage" is undefined. The other hiring credit specifically defines "minimum wage" by reference to the wage established by the Industrial Welfare Commission as provided for in Chapter 1 (commencing with Section 1171) of Part 4 of Division 2 of the Labor Code. This term would need to be defined to effectively implement this bill.

The health benefits wage credit determines the amount of the credit by reference to "qualified wages" as defined in the existing enterprise zone hiring credit. The existing enterprise zone definition of qualified wages is limited to wages received during the first 60 months of employment; however, the health benefits wage credit is for qualified wages for each of the first seven years of employment. Therefore, it is unclear how wages paid in the sixth and seventh year of employment could be considered "qualified wages" for the health benefits wage credit. Such conflicting statutes could make administration of the credit very difficult for the department to administer and could cause disputes between taxpayers and the department.

It is unclear how the credits would be treated if the enterprise zone expires before the end of the six years or seven years in which the taxpayer is eligible for the credit.

The bill limits the credits to wages paid for each of the "first six years of employment" or "first seven years of employment," but does not define those terms. It is unclear when employment commences and what constitutes a year of employment for purposes of either credit. Under the existing enterprise zone hiring credit, employment begins with the first day the employee commences employment with the taxpayer in the enterprise zone. Wages paid during the first five years of employment consist of wages received during the 60-month period beginning with the first day an employee commences employment. However, certain reemployment does not constitute commencement of employment.

Under the existing enterprise zone hiring credit, a qualified employee is one that meets a number of criteria. Taxpayers claiming an enterprise zone hiring credit are required to obtain certification of employee eligibility from a state or local agency. This bill does not have a certification requirement. The absence of a certification requirement could lead to taxpayers claiming the credit for wages paid to employees who have not been certified as satisfying the criteria. Certain criteria of a qualified employee (covered under the certification program for the existing enterprise zone hiring credit) involve determinations that are not within the department's areas of expertise. Certification reduces disputes regarding employee eligibility and thus provides certainty for the employer claiming the credit.

The terms "health benefits," "minimal co-payments," and "full dependent coverage" should be defined to ensure that the author's intention regarding the level of required health coverage is clear.

Technical Considerations

The bill contains a number of minor technical flaws, such as referring to wages or health benefits which are "paid," rather than using the term "paid or incurred." Also, it uses the terms "enterprise zone" and "taxpayer" without clear definitions. Other enterprise zone tax benefits provide clearer definitions for both these terms.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, the following revenue losses are projected to result from this proposal:

Estimated Revenue Impact of SB 1568					
As Amended April 6, 2000					
Revenue Impact	2000/01	2001/02	2002/03	2003/04	2004/05
Additional Zones	N/A	(\$Minor)	(\$1 million)	(\$2million)	(\$5 million)
Hiring Credit	(\$60,000)	(\$120,000)	(\$180,000)	(\$240,000)	(\$300,000)
Health Benefits Credit	(\$200,000)	(\$400,000)	(\$600,000)	(\$800,000)	(\$1 million)
Total Impact (in \$Millions)	(\$260,000)	(\$1 million)	(\$2 million)	(\$3 million)	(\$6 million)

(\$Minor) means losses on the order of \$250,000.

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

It is not possible to predict in advance the location and business characteristics of additional enterprise zones that may be designated in any given year. However, order of magnitude revenue impacts were developed as follows:

1) Additional 11 Enterprise Zones (phased-in):

Based on assumptions used previously for other proposed Enterprise Zones (E/Z) expansions, it is projected that, on average, revenue losses for each additional zone would be less than \$100,000 in the first year after designation, \$250,000 in the second year, \$500,000 by the third full year, and \$1 million in the fourth year. The estimates above reflect this pattern for two additional designations in 2001, a total of six new zones (compared to current law) in 2002, a total of eight new zones (compared to current law) for 2003, and a total of ten new zones compared to current law for 2004.

2) Additional Hiring Credit:

Minor losses projected annually beginning in 2000-1. Approximately \$60,000 impact for 2000-1, \$120,000 for 2001-2, and \$180,000 for 2002-3.

The total number of E/Z employees (working five years or less) qualifying taxable employers for the existing hiring credit is projected to be on the order of 12,000. If the number of new hires under this bill is 1,200 (10%) annually with one-half making \$1,000 more than 150% of the minimum wage, the revenue loss from the 10% credit would be \$60,000 for the first full year.

3) Health Benefits Credit:

Minor losses projected annually beginning in 2000-1. Approximately \$200,000 for 2000-1, \$400,000 for 2001-2, and \$600,000 for 2002-3.

If, for the same number of new hires as above (1,200), as many as 10% (120) earning an average wage of \$17,000 receive full medical coverage from employers, the revenue loss from the 10% credit would be \$204,000 for the first full year.

BOARD POSITION

Pending.